



KEMENTERIAN PERDAGANGAN DALAM NEGERI
DAN KOS SARA HIDUP



SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

Consultative Document on the Proposal of the New Audit Exemption Criteria for Private Companies in Malaysia

Companies Commission of Malaysia (SSM) invites comments on the questions as set out in this Consultative Document on the **Proposal of the New Audit Exemption Criteria for Private Companies in Malaysia**. Please provide your name and the organisation you represent (where applicable) together with your comments.

We welcome comments to be submitted by email by 8 March 2024 to lrpia@ssm.com.my.

Confidentiality: Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has been requested.

PROPOSAL OF THE NEW AUDIT EXEMPTION CRITERIA FOR PRIVATE COMPANIES IN MALAYSIA

PURPOSE

The purpose of this paper is to propose and seek feedback on the new audit exemption criteria for private companies in Malaysia.

BACKGROUND

2. On 2 February 2023, the Companies Commission of Malaysia (SSM) had published a consultative document on the proposal to review the audit exemption criteria for private companies in Malaysia. The existing criteria which were introduced on 4 August 2017 via Practice Directive 3/2017 are as follows:

- (a) Dormant companies –
 - Companies must have either been dormant since the time of incorporation, or dormant during the immediate past and current financial year;
- (b) Zero-revenue companies –
 - Companies must fulfil the following three (3) requirements:
 - (i) No revenue during the current financial year;
 - (ii) No revenue in the immediate past two financial years; and
 - (iii) Total assets do not exceed RM300,000 for the current Statement of Financial Position as well as in the immediate past two financial years; and

(c) Threshold-qualified companies –

- Companies must fulfil the following three (3) requirements:
 - (i) Annual revenue not exceeding RM100,000 during the current financial year and the immediate past two (2) financial years;
 - (ii) Total assets in the current Statement of Financial Position of RM300,000 or less and in the immediate past two financial years; and
 - (iii) Has not more than five (5) employees at the end of its current financial year and in the immediate past two (2) financial years.

3. The consultative document proposed that the thresholds of the existing criteria be revised as follows:

(a) Dormant companies –

- No change;

(b) Zero-revenue companies –

- Turnover: RM 0 (No change);
- Total assets: To increase total assets from RM300,000 to RM500,000 for the current Statement of Financial Position as well as in the immediate past two financial years; and

(c) Threshold-Qualified companies:

- Turnover: To increase annual revenue from RM100,000 to RM1,000,000 during the current financial year and the immediate past two (2) financial years;
- Total assets: To increase total assets in the current Statement of Financial Position from RM300,000 to

RM1,000,000 in the immediate past two financial years;
and

- Employees: To increase from not more than five (5) to not more than thirty (30) employees at the end of its current financial year and in the immediate past two (2) financial years.

COMMENTS AND FEEDBACK FROM THE PUBLIC ON THE PROPOSED REVIEW OF THE AUDIT EXEMPTION CRITERIA

4. In general, 65% of the respondents agreed with the proposal, 21% disagreed whilst 14% has stated that they neither agreed nor disagreed. The respondents comprising mainly audit and accounting practitioners, accounting and audit firms, professional bodies and other regulators.

5. The respondents that agreed with the proposal to increase the threshold of audit exemption criteria were of the view that this will lead to the reduction of the cost of doing business in general and will encourage future progression of Small and Medium Enterprises (SMEs) in Malaysia. Among the respondents who expressed their agreement, 55% believed that the thresholds should be higher to be in-line with other jurisdictions and to afford more SMEs, including medium-sized companies, the opportunity to avail themselves of audit exemption.

6. Reliability of unaudited financial statements and the exposure to high risk of material misstatement or incorrect information are still the main concern of 21% of the respondents who disagreed with the proposal.

7. Despite neither agreeing or disagreeing with the proposal, the 14% of the respondents have shared their opinions regarding the principles and factors that should be taken into account in establishing a more effective audit exemption criteria.

8. In terms of the criteria relating to number of employees, 54% of the respondents agreed that the number of employees for Threshold-Qualified Companies be increased in line with the increase in the revenue threshold and to be aligned with the definition of SME as subscribed by the SME Corporation Malaysia.

9. 32% of the respondents disagree with an increase in the number of employee threshold as they believed that the increase would significantly involve larger entities and therefore auditing of financial statements will be necessary.

10. Similarly, respondents also expressed their view that the number of employees may not accurately measure companies' size in a technology-driven world, as some capital-intensive SMEs require fewer employees due to advancements in manufacturing technology and automation.

11. Respondents also suggested to drop the thresholds for dormant companies and zero revenue companies, and to tweak the condition to only fulfil any 2 of the criteria, or otherwise, to allow audit exemption to a Threshold-Qualifying Company if it meets "two (2) out of the three (3) criteria," rather than requiring fulfilment of all criteria.

12. The underlying principle for this suggestion is to enable audit exemption to be more accessible particularly to holding companies with straightforward income (e.g. rental income), where the financial risks and complexities may be lower compared to other types of businesses. Respondents also opined that this approach is in line with the international requirements, i.e. the United Kingdom, Australia, Singapore and many other countries.

13. To enhance the reliability of unaudited financial statements, respondents also suggested to implement policies that include independent reviews of financial statements or to mandate exempted companies to engage qualified accountants.

14. There are also comments that the threshold should be increased in stages to strike a balance between reducing regulatory burdens and maintaining the necessary level of transparency in financial reporting.

15. Additionally, there were also views on the need to carefully assess the impact of the proposed changes and to ensure that appropriate safeguards are put in place to protect the interests of stakeholders and maintain public trust on the financial information presented by the companies.

REVISED PROPOSAL FOR THE NEW AUDIT EXEMPTION CRITERIA

16. Upon review of the comments and feedback received, SSM is of the view that it is crucial to strike a balance between providing costs relief to smaller businesses and ensuring adequate oversight on financial reporting. SSM also agrees on the importance of setting relevant thresholds based on the financial and operational criteria to identify companies that are less likely to pose significant risks to stakeholders and public interest.

17. Therefore, to ensure that the thresholds are relevant to achieve the objectives of audit exemption, SSM is proposing that the audit exemption criteria be revised as follows:

- (a) To repeal the existing criteria based on the categorization of dormant companies, zero-revenue companies, and threshold-qualified companies. Instead qualifying criteria based on **turnover, assets, and employee thresholds** be adopted. This modification aims at creating a more comprehensive and efficient approach in determining the eligibility for audit exemptions.

- (b) To increase the threshold for each new criterion as follows:
- (i) **Criterion 1:**
 - The annual income of the company during the current financial year and in the immediate past two (2) financial years does not exceed RM3,000,000;
 - (ii) **Criterion 2:**
 - The total assets of the company in the current statement of financial position and in the immediate past two (2) financial years does not exceed RM3,000,000; and
 - (iii) **Criterion 3:**
 - The number of employees at the end of the current financial year and in the immediate past two (2) financial years does not exceed thirty (30).
- (c) To revise the qualifying criteria of fulfilling all 3 criteria to **fulfilling any two (2) of the 3 specified criteria;**
- (d) The above criteria are not applicable to a private company that is a subsidiary of a public company; and
- (e) An Exempt Private Company (EPC) that fulfils the above criteria but opts not to lodge the financial statement with SSM must continue to undergo an audit.

JUSTIFICATIONS

18. The above proposal is derived based on consideration on the following matters:

(a) Reclassification of qualifying criteria

- (i) Different types of companies have varying business models and financial structures. This new approach takes into account the different aspects of companies' business model and financial performance (i.e. turnover and assets) as well as the number of employees in determining their eligibility.
- (ii) Various jurisdictions, e.g. the UK, Australia and Singapore, adopted similar criteria where companies may qualify for an audit exemption if they have fulfilled at least two (2) of the 3 criteria, namely the turnover, assets or number of employees criteria. This revision will align Malaysia's audit exemption practice with international practices.
- (iii) Using relatively straightforward parameters like turnover, assets, and employee headcount would make the implementation of audit exemption criteria more transparent and practical with fewer interpretation errors.
- (iv) Distinguishing the qualifying criteria based on the assets and turnover, and the number of employees will assist companies to tailor their business and financial status with the need for audit.

(b) Fulfilling 2 out of 3 criteria

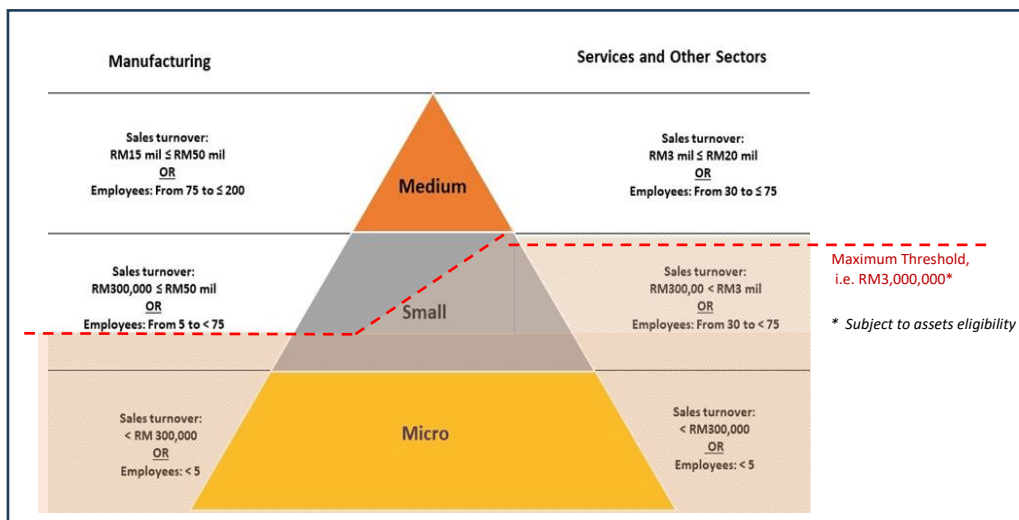
- (i) The proposed approach of fulfilling any two out of the three criteria provides more flexibility, making it easier for companies to understand and comply with the requirement.

- (ii) It could potentially support small businesses by providing more opportunities for audit exemption. Reducing the compliance burden for small businesses with limited resources would encourage entrepreneurship and business growth.

(c) Increasing the thresholds

- (i) It is opined that a higher threshold means that smaller companies, which are significantly below the threshold, can more confidently decide to take up the audit exemption. Since they are far from reaching the threshold, they are unlikely to be required to conduct audit anytime soon.
- (ii) The proposed RM3,000,000 turnover and assets will provide the flexibility for companies in opting for the audit exemption route. This establishes consistency in the company's audit requirements, mitigates uncertainties surrounding eligibility status, and empowers the company to manage its long-term financial planning more effectively.
- (iii) Based on the definition of SMEs provided by SME Corp Malaysia, the proposed thresholds will enable all small and micro companies under the services and other sectors, to avail themselves of the benefit of audit exemption, as shown in the below Diagram 1.

Diagram 1: Proposed Turnover Thresholds for Audit Exemption



- (iv) As of July 2023, according to SSM's records, 77.4% of the financial statements submitted to the Registrar indicated a total turnover of less than RM3,000,000. Similarly, in terms of assets, 74.3% of companies reported total assets below RM3,000,000. These companies are eligible for audit exemption under the new thresholds if they fulfil the proposed eligibility criteria.
- (v) The proposal to increase the number of employees from not more than five (5) to not more than thirty (30) employees is consistent with the definition of SMEs provided by the SME Corp Malaysia.

19. In arriving at the proposal, SSM has also consulted several government agencies that rely on audited financial statements in carrying out their functions such as for the purposes of public procurement, provisions of grants, approval of licencing or permits; to seek their perspectives on the new proposed criteria and thresholds.

20. SSM recognizes the need for these agencies to uphold their current policies which require companies to furnish audited financial statements as part of their procedures. As these are specific requirements imposed by the respective agencies after having taken into considerations various factors such as public interest and the potential risks to government projects, SSM is of the view that requirements for financial statements to be audited will continue to be observed by companies involved.

21. As audit exemption is voluntary in nature, it is the prerogative of each company to consider whether or not it is beneficial to the company. For entities engaging with government agencies and certain business financiers, the auditing of financial statements may persist, and they are obliged to continue auditing their financial statements every year.

22. Similarly, with regards to the proposal to mandate hiring a qualified accountant or to voluntarily undergo an independent audit review, audit-exempted companies are encouraged to proceed if they find it beneficial for their operations and stakeholders. This may include ensuring compliance with specific industry standards and adopting a proactive approach to assess and identify issues in their internal controls or financial reporting processes.

23. As reported in the "Report on the Observance of Standards and Codes in Malaysia - Auditing and Accounting" (ROSC) which was issued by the World Bank in 2013, the demand for statutory audits in relation to the available number of auditors in Malaysia is notably high. This matter is acknowledged with the latest statistics on numbers of active companies registered with SSM as at 31 December 2023 which was 666,767 compared to 1,919 approved auditors.

24. High demand for statutory audits may strain the resources of auditors and impact the overall efficiency and quality of auditing services. The existing shortages in accounting and auditing skills and capacities are

further intensified due to the mandatory requirement for all registered companies to submit audited financial statements.

25. To address these issues and prevent potential harm to the overall reputation of the audit profession, it is imperative to expedite the implementation of audit exemptions for a broader range of companies, particularly non-public interest entities. By increasing the threshold, it will increase the number of companies eligible for audit exemption which will improve the perception of the value of audit reports in Malaysia.

CONCLUSION

26. SSM is of the view that striking the right balance between regulatory reliefs and financial accountability will contribute to a healthy and sustainable business environment for both traditional and technology-driven companies.

27. These adjustments are intended to better reflect the evolving economic landscape and ensure the continued relevance of the audit exemption criteria. By implementing the new thresholds, it will contribute towards better compliance, reduce administrative burdens and promote growth for SMEs in Malaysia.

28. The new policy on audit exemption is also indicative for SSM to strengthen its enforcement by closely monitoring and collaborating with professional bodies to establish clear procedures towards ensuring that financial reporting practices in Malaysia aligns with industry standards and international norms.

29. Nevertheless, the key to successfully improve the take-up rate on audit exemption lies in effective communication to create awareness, simplified processes and clear benefits for eligible businesses.

30. In summary, SSM is of the view that the new qualifying criteria will strike a balance between economic reliefs and regulatory requirements. The new qualifying criteria aims at benefitting most of the smallest companies whilst bigger companies with better resources are required to comply with the financial reporting requirements fully.

31. SSM invites any views and feedback on the proposed new audit exemption criteria by 8 March 2024.

The Registrar
Companies Commission of Malaysia
Date: 7 February 2024